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7 MAY 1976

MEMORANDUM FOR: Office of Legislative Counsel

ATTENTION :

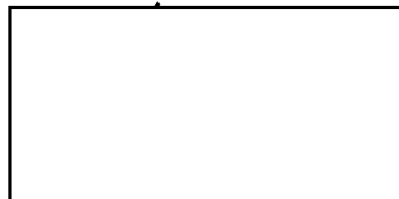
FROM :

Chief, Cover & Commercial Staff

SUBJECT : Pending Compromise of Agency
Proprietary Organizations

REFERENCE : C/CCS memo to Office of Legislative Counsel
dated 5 May 1976, same subject as above.

Your office has asked for a copy of exerpts from the Rockefeller Commission Report and the Senate Select Committee Report which support certain statements made in reference. The applicable exerpts are attached hereto.



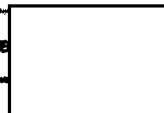
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Exerpts as stated
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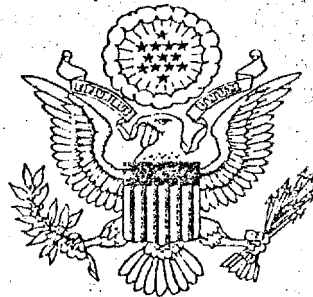
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SECRET

June 1975

Report to the President
by the
COMMISSION ON
CIA ACTIVITIES WITHIN
THE UNITED STATES



(COMMONLY REFERRED TO AS THE ROCKEFELLER REPORT)

a large reservoir of foreign intelligence; they are by far the most accessible source of such information.

The division's files on American citizens and firms representing actual or potential sources of information constitute a necessary part of its legitimate intelligence activities. They do not appear to be vehicles for the collection or communication of derogatory, embarrassing, or sensitive information about American citizens.

The division's efforts, with few exceptions, have been confined to legitimate topics.

The collection of information with respect to American dissident groups exceeded legitimate foreign intelligence collection and was beyond the proper scope of CIA activity. This impropriety was recognized in some of the division's own memoranda.

The Commission was unable to discover any specific purpose for the collection of telephone toll call information or any use of that information by the Agency. In the absence of a valid purpose, such collection is improper.

B. Provision and Control of Cover for CIA Personnel *

CIA personnel engaged in clandestine foreign intelligence activities cannot travel, live or perform their duties openly as Agency employees. Accordingly, virtually all CIA personnel serving abroad and many in the United States assume a "cover" as employees of another government agency or of a commercial enterprise. CIA involvement in certain activities, such as research and development projects, are also sometimes conducted under cover.

CIA's cover arrangements are essential to the CIA's performance of its foreign intelligence mission. The investigation has disclosed no instances in which domestic aspects of the CIA's cover arrangements involved any violations of law.

By definition, however, cover necessitates an element of deception which must be practiced within the United States as well as within foreign countries. This creates a risk of conflict with various regulatory statutes and other legal requirements. The Agency recognizes this risk. It has installed controls under which cover arrangements are closely supervised to attempt to ensure compliance with applicable laws.

C. Operating Proprietary Companies *

The CIA uses proprietary companies to provide cover and perform administrative tasks without attribution to the Agency. Most of the large operating proprietaries—primarily airlines—have been liqui-

dated, and the remainder engage in activities offering little or no competition to private enterprise.

The only remaining large proprietary activity is a complex of financial companies, with assets of approximately \$20 million, that enable the Agency to administer certain sensitive trusts, annuities, escrows, insurance arrangements, and other benefits and payments provided to officers or contract employees without attribution to CIA. The remaining small operating proprietaries, generally having fewer than ten employees each, make nonattributable purchases of equipment and supplies.

Except as discussed in connection with the Office of Security (see Chapters 12 and 13), the Commission has found no evidence that any proprietaries have been used for operations against American citizens or investigation of their activities. All of them appear to be subject to close supervision and multiple financial controls within the Agency.

D. Development of Contacts With Foreign Nationals

In connection with the CIA's foreign intelligence responsibilities, it seeks to develop contacts with foreign nationals within the United States. American citizens voluntarily assist in developing these contacts. As far as the Commission can find, these activities have not involved coercive methods.

These activities appear to be directed entirely to the production of foreign intelligence and to be within the authority of the CIA. We found no evidence that any of these activities have been directed against American citizens.

E. Assistance in Narcotics Control

The Directorate of Operations provides foreign intelligence support to the government's efforts to control the flow of narcotics and other dangerous drugs into this country. The CIA coordinates clandestine intelligence collection overseas and provides other government agencies with foreign intelligence on drug traffic.

From the beginning of such efforts in 1969, the CIA Director and other officials have instructed employees to make no attempt to gather information on Americans allegedly trafficking in drugs. If such information is obtained incidentally, it is transmitted to law enforcement agencies.

Concerns that the CIA's narcotics-related intelligence activities may involve the Agency in law enforcement or other actions directed against American citizens thus appear unwarranted.

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E. Howard Hunt. Use of U.S. alias documentation, such as driver's licenses and credit cards, has been severely limited and requires approval of senior officers under the overall control of the Agency. Alias documentation may be issued to other agencies only with approval of the Deputy Director of Operations. All such documentation must be accounted for every six months.

In 1969 the statement of functions of the office responsible for cover arrangements was revised to eliminate the authority, formerly held, to provide charitable organizations and individuals for inserting funds into organizations and programs supported by the Agency.

Finally, the occasional provision of cover to other agencies has been terminated.

Growing public familiarity with the Agency's use of cover has led to a tendency to identify many government and some private activities with the CIA—frequently without justification.

This has had an unfortunate tendency to impair the usefulness of some non-Agency related government activities. In addition, it has progressively tended to narrow available cover arrangements for the Agency.

Conclusions

CIA's cover arrangements are essential to the CIA's performance of its foreign intelligence mission. The investigation has disclosed no instances in which domestic aspects of the CIA's cover arrangements involved any violations of law.

By definition, however, cover necessitates an element of deception which must be practiced within the United States as well as within foreign countries. This creates a risk of conflict with various regulatory statutes and other legal requirements. The Agency recognizes this risk. It has installed controls under which cover arrangements are closely supervised to attempt to ensure compliance with applicable laws.

C. Operating Proprietary Companies

In addition to the proprietary companies created solely to provide cover for individual CIA officers, CIA has used proprietary companies for a variety of operational purposes. These include "cover" and support for covert operations and the performance of administrative tasks without attribution to the Agency.

It has been charged that certain of these Agency-owned business entities have used government funds to engage in large-scale com-

mercial operations, often in competition with American private enterprise. There was a limited factual basis for these allegations in the past, but the investigation has disclosed that the Agency has liquidated or sold most of its large operating proprietaries. The remainder engage in activities of limited economic significance, providing little if any competition to private enterprise.

By far the largest part of the Agency's proprietary activity consisted of a complex of aviation companies, including Air America, Southern Air Transport, and Intermountain Aviation, Inc. These companies, which at one time owned assets in excess of \$50 million, provided operational and logistic support as well as "cover" for the Agency's foreign covert operations, primarily in Southeast Asia.

The investigation has disclosed that some of the services provided by the air proprietaries were competitive with services of privately owned firms, both at home and abroad. However, most of the aviation companies have been liquidated or sold and the rest are expected to be disposed of shortly. This will end the Agency's commercial involvement in the aviation field. Proceeds of these liquidations and sales are not used by the Agency; they are returned to the United States Treasury as miscellaneous receipts.

Another major proprietary activity consisted of the operation of Radio Free Europe and Radio Liberty, which beamed broadcasts to Eastern Europe. These stations, originally owned and operated by the CIA, provided both facilities and "cover" for the CIA's educational and cultural activities.

Although these stations were funded by the CIA, they appealed for contributions to the public without disclosing their CIA connection.

However, ownership and control of these stations was turned over to the State Department, which operates them today without concealing the government connection.

The major remaining proprietary activity of the Agency involves a complex of financial companies. These companies enable the Agency to administer certain sensitive trusts, annuities, escrows, insurance arrangements, and other benefits and payments provided to officers or contract employees without attribution to the CIA. Their assets presently total approximately \$20 million, but the financial holdings of the companies are being reduced.

Most of these funds are invested abroad in time deposits and other interest-bearing securities. Less than 5 percent of these funds are invested in securities publicly traded in the United States, but these investments are being liquidated and the proceeds returned to the Treasury. At no time has one or any combination of these companies owned a controlling interest in any firm with publicly traded securi-

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ties. The investigation has disclosed no evidence of any violations of law by the CIA in connection with the making or management of these investments.

The Agency continues to maintain a limited number of small proprietaries as well. Their purpose is primarily to provide cover for the activities of certain officers, agents, and contractors and to make nonattributable purchases of equipment and services. These companies are distinct from the so-called devised facilities in that they are engaged in actual commercial or professional activities, although of modest proportions. Generally, they have fewer than 10 employees.

The Agency also provides small amounts of subsidies and operational investments to firms engaged in activities abroad useful to its missions.

With few exceptions, the CIA's operating proprietaries have been unprofitable and have required continuing budgetary support. Revenues derived from operations have been offset against operating costs. Only two proprietaries are reported to have generated significant profits: Air America in the performance of United States government contracts in Southeast Asia, and several of the financial companies in return on investment. In both cases, profits were, in the past, retained for use by the proprietary companies pursuant to the General Counsel's opinion that these funds need not be returned to the Treasury.

The creation, operation and liquidation of operating proprietaries is closely controlled by high Agency officials. All such projects must have the approval of the Deputy Director of Operations or his assistant. Sensitive or substantial cases must be approved by the Director of Central Intelligence. Each requires an administrative plan which must have the concurrence of the Deputy Director of Operations, the Office of General Counsel, the Office of Finance and certain other senior officers. Expenditures or reimbursements must be approved by responsible senior operating and finance officers. All projects are subject to annual review as a part of the budget process and regular audits are made.

A related activity of the Agency has been to support foundations, principally the Asia Foundation, which also served as both a vehicle and cover for educational and cultural activities abroad. The Agency's connection with that foundation has been terminated.

The Agency in the past has also provided a lesser measure of support to other foundations and associations thought to be helpful to its mission. A prime example was the National Student Association, which sponsored American students who participated in international meetings and activities. Until 1967, when *Ramparts* magazine revealed the fact, CIA offered some support to that activity. A resulting

report by a committee under then Deputy Attorney General Nicholas DeB. Katzenbach led to directions to CIA to terminate support of American foundations and voluntary associations. So far as the Commission has been able to determine, the Agency has complied.

Conclusions

Except as discussed in connection with the Office of Security (see Chapters 12 and 13), the Commission has found no evidence that any proprietaries have been used for operations against American citizens or investigation of their activities. All of them appear to be subject to close supervision and multiple financial controls within the Agency.

D. Development of Contacts With Foreign Nationals

Another significant domestic activity of the CIA consists of efforts to develop contacts with foreign nationals who are temporarily within the United States. This activity is within the United States, and its primary purpose is to develop sources of information. As far as the Commission can determine, coercive methods, such as blackmail or compromise, have not been used.

The CIA enlists the voluntary assistance of American citizens in its efforts to meet and develop contacts with foreign nationals. These citizens are not compensated for their services, but may be reimbursed for any expenses they incur. They are fully aware that they are assisting or contributing information to the CIA. At all times, they are free to refuse or terminate their cooperation.

Prior to requesting the aid of an American citizen in this manner, the Agency occasionally obtains a name check through its Office of Security, but does not otherwise investigate such persons. In most cases it will maintain a file on such an individual containing biographical information and a brief history of the person's cooperation with the division. No records are kept by this division with respect to persons who decline to assist the Agency.

Under a written agreement with the FBI, any information of an internal security or counterintelligence nature which comes to the division's attention in the course of these activities is immediately referred to the Bureau.

The Commission's investigation has disclosed no evidence that the division in question has been used to collect information about American citizens or their activities at home or abroad.

94TH CONGRESS }
2d Session }

SENATE

REPORT
No. 94-755

FOREIGN AND MILITARY INTELLIGENCE

BOOK I

FINAL REPORT OF THE SELECT COMMITTEE TO STUDY GOVERNMENTAL OPERATIONS

WITH RESPECT TO
INTELLIGENCE ACTIVITIES
UNITED STATES SENATE

TOGETHER WITH
ADDITIONAL, SUPPLEMENTAL, AND SEPARATE
VIEWS



APRIL 26 (legislative day, APRIL 14), 1976

fund set aside and earmarked for independently initiated activities.¹² [Emphasis in the original]

He emphasized that if the Agency did not take the above kind of action to monitor its "image" at the operational level, it would "continue to be plagued with the unsolicited and uncontrolled critique through the newspapers, periodicals and books." He critically concluded:

Further, I challenge anyone to deny that such exposes to date are largely true and usually the result of our own "ostrich policy," and refusal to face the fact that we have operated in some relatively amateurish manners over the years.¹³

Such concerns have extended beyond these operational levels to general issues of propriety and legality. As noted earlier, the so-called "Anti-Pinkerton Act" prohibited the Office's continued contractual relationship with private companies or their employees for purposes of conducting investigations or providing cover. The General Counsel responded as follows:

I am aware that in fulfilling the responsibilities placed upon your office in support of the Agency's mission, many investigations must be conducted without revealing Government interest. Absent the relationships you question, you could not discharge your responsibilities. It is this inability to accomplish your tasks which causes recourse to the Agency's rather broad statutory authority to expend funds as contained in Section 8 of the CIA Act of 1949, as amended. This authority provides

(a) Notwithstanding any other provision of law, sums made available to the Agency by appropriation or otherwise may be expended for purposes necessary to carry out its functions, including--

(1) personal services, including personal services without regard to limitations on types of persons to be employed, . . .

(b) The sums made available to the Agency may be expended without regard to the provisions of law and regulations relating to the expenditure of Government funds; and for objects of a confidential, extraordinary, or emergency nature, such expenditures to be accounted for solely on the certificate of the Director and every such certificate shall be deemed a sufficient voucher for the amount therein certified.

It is my opinion that this authority permits the Agency to continue the two practices as set out above without fear of violation of the Anti-Pinkerton Statute.¹⁴

He closed, however, with the following admonitions:

There are, of course, other dimensions of the question you raise. As a matter of policy I believe the practices should be reviewed at the highest levels within the Agency and, per-

¹² *Ibid.*

¹³ *Ibid.*

¹⁴ Memorandum from General Counsel to Director of Security, 6/64.

haps, cleared with the Agency's oversight committees. In addition, if one of these relationships became public, it must be recognized that there will be allegations that the law has been violated. On balance, it is my view that these considerations are not so significant as to warrant a termination of the two practices with the three companies. It is suggested, however, that any subsequent projected association with a detective company or private investigative company beyond the three present companies be reviewed with this Office prior to its initiation.¹⁵

The Insurance Complex

This proprietary is a complex of insurance companies, most of which are located abroad, operated by the Agency to provide the following services:

- (i) Handling of risks ostensibly covered under commercially issued policies;
- (ii) extending term life insurance, annuities, trusts and workmen's compensation to Agency employees who are not entitled to United States Government benefits;
- (iii) handling escrow accounts for agents; and,
- (iv) limited operational support and investment activities.¹⁶

Origin.—Prompted by the Bay of Pigs losses, the complex was created in 1962 to provide death and disability benefits to agents and beneficiaries when security considerations preclude attribution to the United States Government. Lawrence Houston, retired General Counsel of the Agency, testified that his office established the insurance investment complex, because his staff was responsible for all problems related to the death or disability of employees during the course of their Agency work. These problems were all handled in what Houston called a very "sketchy way" which he felt was undesirable from all points of view. When the Agency went into air proprietaries on a large scale, additional risks arose which simply could not be underwritten commercially.

So somewhere in the late 1950s or around 1960, I think I was the one that posed that we might organize our own insurance entities.¹⁶

A single event served as the catalyst for the establishment of the complex. Houston recalled in latter testimony that

the event that brought it into focus was the death of four airmen in the Bay of Pigs. These men were not supposed to have engaged in the fighting and were training on the mainland, but when the Cubans were either exhausted or unable to fly anymore, they pitched in, went over the beach, and were shot down.

¹⁵ *Ibid.*

¹⁶ Escrow accounts are established when an agent cannot receive his full payment from the CIA without attracting suspicion. The funds not paid to the agent go into escrow accounts and are invested under the complex.

¹⁷ Lawrence Houston testimony, 1/15/76, p. 61.

We heard of this for the first time the next morning and Allen Dulles called me over and said, you'll have to make some provision for the families of those four fliers . . .

Through [an ad hoc] mechanism we paid benefits to the family for a considerable length of time until we were able to turn it over to the Bureau of Employees Compensation.

This was a very makeshift arrangement, and so based on that I came to the conclusion that we needed a much more formal and flexible instrument. And so after long consideration within the Agency we acquired the first two insurance entities which had been in being before and then we flushed them out a little bit.¹⁷

Thus the formation of this entity represented the "culmination of experience" in this support area, according to Houston. Although the complex originally operated under the Domestic Operations Division a special board of directors later assumed control of the priorities and their investments. In July 1973 control of the complex was transferred to the Commercial and Cover Staff.

The Current Status.—All of the clients of the project are Agency employees.¹⁸ The complex was originally capitalized in 1962 with \$4 million. Most of the assets are held outside the United States and the companies do not write insurance in the United States. Each of the United States companies pays little tax and is audited by a proprietary firm. This method of self-insurance enables the Agency to funnel money where needed in any of its project categories. Currently, 60 percent of the investments are in long-term interest bearing securities abroad, 20 percent in off-shore time deposits in United States banks, and the balances in common stocks, debentures and commercial paper of various types. In the past twelve years the sale of stocks has resulted in profits in excess of \$500,000 accruing to the CIA. The combined total assets of the complex are in excess of \$30 million, including its retained net earnings of approximately \$9 million.

In 1970 the Inspector General examined the insurance complex. His report raised questions about briefing congressional oversight subcommittees which indicate that Congress had never been informed of the existence or extent of the insurance complex which had grown to an organization with assets of \$30 million without oversight, knowledge or approval. While annual audits of the complex were conducted, there was no annual allotment and no annual operational review within the CIA, because the insurance activity was no longer a true project after its removal from the Domestic Operations Division.

¹⁷ Houston, 1/27/76, p. 8.

¹⁸ The complex itself is only for covert non-staff officers of the CIA. In essence, it only works for what would broadly be described as "agents" those not entitled to participate in the CIA retirement plan or in the Civil Service Retirement Plan. They are primarily foreigners, and usually work for DDO. In the case of most agents, the CIA contributes 7 percent and the agent contributes 7 percent. In keeping with CIA practice for regular employees. In cases where the agent is well along in years and contributions from the Agency and the agent would not provide enough funds to capitalize an annuity, the Agency provides the initial capitalization; however, such an arrangement must be approved by the DDO.

Houston indicated that the complex had been operating "for some time" before

we told our committees any detail. I think it was mentioned as a problem that we had to make arrangements to cope with insurance problems fairly early on. But the fact that it was a business and a business of this substance was not done for some time. My recollection is there was not deliberate avoidance; we just didn't get to it.¹⁹

With regard to buying and selling securities, the Committee sought to discover whether the CIA has any method of preventing personal profit-taking by Intelligence Directorate analysts who have access of clandestinely collected economic intelligence. The CIA has indicated that such an analyst would be in the same conflict of interest position as a staff member of the Securities and Exchange Commission, Department of Agriculture, or any other Government agency for misuse of confidential material. Moreover, financial reporting requirements are imposed upon CIA employees.

Similarly, the Committee attempted to determine whether financial transactions were made by the complex to influence foreign stock markets or currencies. The 1970 review by the Inspector General found no evidence of such influence. Neither did the Committee. All witnesses and documentary evidence indicated that the complex was never so used. Indeed, all agreed that the amounts involved in the fund were insufficient to destabilize any currency or market, even if such effort had been made.

The complex was subject to an audit in 1974 which concluded that it "continued to be administered in an efficient and effective manner, and in compliance with applicable Agency regulations and directives." Prior audit reports had commented on the need for a revised administrative plan. In accordance with earlier reports, the 1974 audit noted, a "new plan was approved in March 1975." In addition, "minor administrative and financial problems surfaced during the audit were discussed with [project] officials and resolved. The audit noted that *total income* for that year (from interest, premiums, gain or loss on sale of securities, dividends, rentals, professional fees, gain on foreign exchange, gain on sale of property and from miscellaneous transactions) was in excess of \$4 million. The *total expenses* for that year (allocation of premium income to reserve for interest, salaries, rent, accounting fees, taxes, loss on property write-off, legal and other fees, communications, depreciation and amortization, travel, equipment rent, real estate expenses, pensions, directors' subscriptions, directors fees, entertainment and miscellaneous) were nearly \$2.5 million. These combined for a net income in excess of \$1.5 million.²⁰

The current Chief of the Cover and Commercial Staff has focused on the insurance-investment project in a number of interviews with both the Rockefeller Commission and the Committee. He has suggested that the real question for the complex is what its role and shape should be after the termination of many of the Agency's proprietary

¹⁹ Houston, 1/15/76, p. 81.

²⁰ 1974 Audit of Insurance Complex.

ties. With their liquidation, he believes a reorganization and redefinition of the insurance-investment complex is needed.

As to the issue of a safeguard against misuse of project funds or "insider" information by the Agency, the Chief of CCS has told the Committee that the guarantees against such abuse are (1) compartmentation; (2) the integrity of the Chief of CCS; and (3) display of portfolios to appropriate congressional committees.²³

Houston agreed with the three safeguards outlined by the CCS Chief. However, he added a fourth:

When we were investing in stock, I would have the list of stock, the portfolio, reviewed by our contract people, and if I found we had any contract relationship with any of the companies involved, we'd either refuse to—Well, a couple of times our investment advisor recommended a stock which I knew we had big contracts with, and I told the board no, this involves a conflict of interest. We won't touch it. And if we had anything from the Agency contract office that indicated a relationship, we would either sell the stock or wouldn't buy it.²⁴

Houston believes that the complex should continue in some form and that the current method, while not perfect, is the best that can be devised. The problem is that the generation of funds for these companies must be demonstrably legitimate and nongovernmental if beneficiaries are to be protected; i.e., the absence of investment by an insurance corporation could well indicate to outsiders that its funding is actually coming from the Federal Government.

Behind "Doing Business": Peak Non-Government Security Investments by Proprietaries Active as of Dec. 31, 1974.—The insurance and pension complex has sizable investments in both domestic and foreign securities markets. Its portfolio runs the gamut of notes, bonds, debentures, etc. But other proprietaries have also used this investment route as a method of increasing capital and insuring adequate cover.

For example, a domestic corporation purchases general merchandise in a manner which cannot be traced to the United States Government. It provides covert procurement for the CIA Office of Logistics.

While this corporation has no outside commercial business and only five employees, as of December 31, 1974, it had invested over \$100,000 in the deposits. A second domestic corporation purchases arms, ammunition, and police-related equipment for the Office of Logistics. This company has no employees and is managed by Headquarters officials in Dallas. As of December 31, 1974, this corporation had invested more than \$30,000 in a certificate of deposit.

A travel service proprietary was recently sold to an Agency employee at the time of his retirement. This employee had ostensibly owned the firm, but had in fact managed it for the Agency. As of

²³ Chief, CCS, 1/27/76, pp. 15-16.

²⁴ Houston, 1/15/76, p. 80.

The current charter for the insurance complex and the administrative plan forbid further acquisition of U.S. stocks and require the divestiture of American equity investments in the immediate future.

December 31, 1974, this corporation had invested more than \$30,000 in a certificate of deposit.²⁵ An investment proprietary, which was later dissolved, had invested about \$100,000 in Mexico as of March 31, 1973. A Delaware corporation, which has provided secure air support for Agency employees and classified pouches between Headquarters and other Agency facilities in the United States, has nearly \$150,000 invested in a certificate of deposit.

A former youth activity proprietary, in which the Agency no longer retains an interest, had approximately \$50,000 invested in time deposits as of March 31, 1972. Another proprietary is part of a complex managed by the Cover and Commercial Staff which provides operational support for foreign operations. It is a Delaware corporation used to collect proceeds from the sale of Agency proprietary entities and to refund such proceeds to the Agency. Its total stockholders were nearly three-quarters of a million dollars and its total stockholders equity was in excess of \$15,000 as of December 31, 1973. It has no employees. As of December 31, 1974, it had invested almost half a million dollars in a convertible subordinated debenture from the sale of a company and almost \$50,000 in notes receivable.

Another company in this complex is a foreign company which has been used as an investment vehicle for funds earmarked for noncommercial operations requiring Agency investments. This investment project has been terminated and all funds were returned to the Agency. The company has no employees. As of December 31, 1973, it had invested nearly a quarter of a million dollars in a Security Note of a private domestic corporation.

A proprietary which was part of the air support complex had invested over \$200,000 in a certificate of deposit as of December 31, 1974. This entity was later sold. Another is part of the management and accounting complex. As of December 31, 1974, it had nearly 11 million dollars invested in time deposits.

The Air Proprietaries

History.—Lawrence R. Houston, former CIA General Counsel, was involved in the establishment of the first set of Agency proprietaries, and has concluded that they should be a mechanism of last resort. Houston maintains that the Agency learned this "the hard way and almost all of the lessons involved probably came out on the way or the other in connection with a major aviation proprietary the Far East. Others had their own special problems, but I think the Air America complex had pretty near everything."²⁶

The Agency acquired Air-America in 1949 extensively to deal the assets of this company to the Communist Chinese. The CIA first arranged cash advances to the company in 1949. These advances were eventually credited to the Agency's purchase of the corporation. At that time, Houston described the airline as follows:

This normal aviation organization, this would have no meaning at all, was completely at all, it would have no standing

²⁵ The Agency today uses this firm for the purchase of airline tickets for travel in support of sensitive projects. It is estimated by the Agency that CIA business represents about 30 percent of the gross airline ticket sales of the entity on an annual basis.

²⁶ Houston, 1/15/76, p. 5.

run airlines in remote areas or on commercially unattractive routes. Would private enterprise do any or all of these things? It is true that private contracts with the Government include highly sensitive contracts with the CIA for technical intelligence collection, research, and development. Would the abandonment of CIA proprietaries and the cooperation of private firms be more desirable in terms of policy, economy or flexibility?

3. *Relative Scarcity of Commercial and Official Cover*

The continuing CIA desire for more notional cover reflects the scarcity of United States Government official cover in many areas of the world, and the developing desire of some United States companies not to cooperate with the Agency.

4. *Profits*

Some questions concerning profits have been raised. Does proprietary profit constitute a significant addition to the resources available to CIA? How is such profit treated in the budget? How is it controlled? How can the Congress (or the President, for that matter) be sure that proprietary profits are not diverted to projects not included in the regular CIA budget?

First, profits (defined as net income to a proprietary after deduction of operating expenses) are relatively small. Even in the days when the most profitable air proprietaries were operating at peak capacity, the most that any single firm netted was less than \$4 million. Over the entire period 1947-1975, total profits have been \$50 million, an average of about \$1.6 million annually, for the 16 biggest CIA proprietaries. And in these years, a net loss was sustained three times—\$2.5 million in 1971; \$0.5 million in 1973; and \$0.3 million in 1975.

Looking to the future, after liquidation of the air proprietaries has been completed, there is forecast to be only one profitable proprietary: the complex of insurance companies which derives most of its profit from investment portfolios. This entity's net income in 1974 was less than \$2 million and a profit of this general magnitude is expected in the foreseeable future. These profits are to be used only for the insurance, escrow, annuity and related complex functions. Neither the complex, nor profits accruing to it, are used for operational support of any other projects or activities. Nevertheless profits from all proprietaries may be reprogrammed into CIA operations due to a "change in policy" reflected in the General Counsel's decision of February 3, 1975.⁹⁰ Thus proprietaries do not presently provide a mechanism for "back door" funding of covert operations; nor are they currently intended to do so.⁹¹

The current Chief of CCS noted that:

It may be the questions that have been raised by the staffs of this Committee and of the House Committee, have kind of energized certain action as far as our Comptroller is concerned, as far as the Office of Management and Budget is concerned, and a methodology is being developed at the present time that the balance sheets of the salient information of

the operation of proprietaries, particularly those that are having earnings, are annexed to the budgetary presentation process and review process, so that this information is available to the Office of Management and Budget, and I assume to Congress, so that this can be taken into consideration.

And you would then have, it seems to me, a degree of safeguard that money cannot be taken out of there and used as an add-on to appropriated funds.⁹²

According to the testimony, from 1973 to 1975, before the opinion was rendered by the General Counsel of the CIA concerning profits and their treatment, the Appropriations Committees were advised that such profits existed, and "it was taken into consideration at the time of appropriations."

In the future, I would think that any oversight committee could very promptly bring to the attention of the DCI their interest in this question of profit, and ask for an accounting, and certainly could be assured that there was no use of funds derived from a proprietary for an operational purpose unrelated to such activity.

I would think . . . the DCI would be under the same prohibition using funds that were appropriated for the intelligence directorate for operational purposes or any other comparable redesignation of funds.⁹³

When asked whether funds built up in a complex such as the insurance proprietary should be used for purposes beyond those included in an annual authorization, an Agency representative replied:

I would view them as segregated funds to the extent that there was a profit, unnecessary for the purposes of the proprietary, that the profit would have to be turned over to the Treasury and it could not be used for other Agency programs.⁹⁴

As for the treatment in the budget, there are both policy and procedural aspects. The policy of CIA was changed by the February 1975 General Counsel ruling that profits of proprietaries and proceeds of liquidation must be returned to the Treasury as miscellaneous receipts and cannot be used to augment the Contingency Reserve or otherwise be applied to operations. This ruling overturned the practice of the past which on occasion included the transfer of proprietaries' net proceeds to the Contingency Reserve for later release to operations.

The budgetary presentation and review procedures only partially focus upon proprietary profits. The insurance complex's profits are invisible in the Agency budget; they are taken into account and subject to scrutiny only within CIA. Operationally, the Directorate of Operations' annual review has the most detailed grasp of these monies at the Agency review levels. A standard set of public release fund schedules, as prescribed by OMB Circular A-11, would be appropriate for making this complex visible in the Agency budget. Other commercial proprietaries should show these schedules as well. The Agency has in

dictated that the Comptroller is working with the Directorates of Operations and Administration to develop more comprehensive budgetary presentation and review procedures for CIA proprietaries.

To what extent can these new procedures prevent abuses of proprietary profits? To what extent do they preclude the need for legislation in this area? What form of Congressional oversight is needed here; at what point should Congress exert control.

Improvement of visibility in the budget of proprietary resources and provision for review of the major proprietaries as a regular part of budget review by CIA, OMB, and Congressional Committees would seem to preclude most of the dangers of abuse. On the other hand, there is one type of abuse for which additional Congressional scrutiny and safeguards may be needed: the possibility of a small-scale, high-risk covert project directed by the President or DCI which is not covered by the regular appropriation but financed by proprietary profits. While no foolproof preventives can be designed by law or regulation, the possibility of such abuse, or the avoidance of congressional review, can be minimized by requiring that all CIA proprietaries report operational activities to the congressional oversight committee.⁹⁵

Private Investment by CIA

Two types of general issues are raised by investments made by the Agency:

(1) Should the CIA engage in investments which could accumulate funds outside the budget process and thus be available for operations that have no public scrutiny outside CIA?

(2) Is CIA investment policy too restrictive in regard to bank deposits? Specifically, should the CIA place large amounts of money in commercial banks without drawing interest?

A sizable percentage of the Agency's annual appropriated and advanced funds are deposited here and abroad in commercial accounts on an incremental basis to fund operational needs. If accounts are maintained at levels above the minimum balance necessary for offset to the bank, the banks selected earn an interest or investment bonus. The selection of these institutions is non-competitive, rooted in historic circumstance, albeit in institutions that have shown themselves flexible and responsive in providing the Agency services. Further investigation of this area is needed, and we encourage the new oversight committee to study this issue in greater detail than we have been able. This is one area where the exclusion of the General Accounting Office from CIA audits has had an unfortunate effect: there is no outside reviewer of a complex set of financial records and, consequently, confidence in the Agency's role in this area may have been eroded.

6. What is the Future for Proprietaries?

No new proprietaries are in formation or planned. This past fiscal year, 1973, one new proprietary was created which rented office space for an East Coast CIA base and provided cover for Agency employees. The main provision for new growth is the plan of some years standing for establishment in the insurance complex of several corporate

"shells" i.e., legally constituted and registered companies that do very little commercial business but which can be adapted to various new CIA missions. To adapt to these new missions, as noted, would require CIA to amend the insurance complex Administrative Plan. But this could be done quickly; the existence of the shells avoids the leadtime of creating new corporate entities, with all the complications of local laws and risk of exposure.

While CIA proprietaries are now smaller than previously, they are so largely for administrative reasons, i.e., response to executive branch directions. Although the CIA may never find proprietary expansion to be operationally desirable, there is currently no statutory constraint on such expansion. Congress should be a partner in the process of reviewing any such expansion by providing for changes in the charter process. Another approach is establishing substantive guidelines for proprietary operation. This approach is typified by the post-Katzenbach guidelines that prohibit CIA operation of tax-exempt foundations.

Lawrence R. Houston, the former General Counsel of the Agency, was intimately involved with all of the proprietaries for his entire tenure with CIA. Consequently, his views have been invaluable to the Committee in reviewing and evaluating the history and the role of these mechanisms. In the course of far-ranging testimony with the Committee on several occasions Houston concluded that proprietaries "should be the last resort for use to backstop Agency activities." I grounded his opinion on the fact that:

they are cumbersome. To be properly run they take many, many man-hours of many, many different parts of the Agency, so they are expensive in man-hours. There are built-in difficulties in running what appears to be a normal business for operational purposes. There's really a built-in dichotomy there that leads to a continual conflict with policies. And due to the number of people involved, there is a security problem on the old grounds that security doesn't go by the mathematical increase in the number of people. It goes geometrically as to the number of people, the security risk.⁹⁶

This assessment appears to be correct based on the evidence reviewed by the committee.

The current Director of Central Intelligence has insisted on streamlining such operations and is keenly aware of the potential for abuse. It is, for example, the current written policy of the Agency that "the degree that domestic proprietary or cover companies are required, a clear justification will be developed as to the relationship of the support of our overseas operations."⁹⁷

In the one area of continuing large-scale activity, the investment complex, the Agency has moved to insure propriety even in an area where there is no evidence that any illegal conduct has occurred. The current policy, established as of June 1973 is:

[The project] will be operated in conformance with appropriate legal restrictions. Arrangements are being made for the

⁹⁵ See Recommendation 50.

⁹⁶ Houston, 1/15/73, p. 4.

briefing of the appropriate Congressional committees. Particular attention will be given to avoiding any possible conflict of interest situations with firms with which the Agency has contracts. Particular concern will also be exhibited over possible improper influence on the stock market or stock dealings through the investments involved in [the project].³³

The Committee is mindful of the potential danger inherent in such operations. Therefore, it recommends that the review of this and other similar projects by the appropriate oversight Committees be most stringent.

The disposal of proprietaries has also generally proceeded along legal and ethical lines with more than due concern for conflicts of interest. Most notable in this spectrum of actions was the degree to which the Agency avoided conflicts of interest in the sale of Southern Air Transport. Such internal vigilance no doubt should and will continue. Moreover, with the establishment of a permanent oversight committee, the CIA's reporting will be made easier because it will be able to report on its dealings on a regular basis to informed Members of Congress.

³³ *Ibid.*